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IN THE

Supreme Court of the United States

Spring Term, 1972

No.

WACHOVIA BANK AND TRUST COMPANY,
Petitioner

v.

R. KENNEDY HARRIS, TRUSTEE OF THE ESTATE OF CABANA CLUB APARTMENTS, INC.,
Respondent

IN THE MATTER OF:

CABANA CLUB APARTMENTS, INC.,
Debtor

BRIEF OF RESPONDENT-DEBTOR IN OPPOSITION TO PETITION OF WACHOVIA BANK AND TRUST COMPANY FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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INTRODUCTORY NOTE

For brevity and convenience, Wachovia Bank and Trust Company, Petitioner, will sometimes be referred to as Wachovia, R. Kennedy Harris, Trustee, will be referred to as Respondent, and Cabana Club Apartments, Inc., will be referred to as Debtor. Page references to the Appendix to Petition are designated (A—). All italics in the text of this brief are supplied unless otherwise noted. Findings of Fact are designated "F.F."

STATUTES INVOLVED

While the several statutory provisions cited in Wachovia's Petition form the basic procedures under which the proposed Plan of Reorganization was ultimately approved by the Referee (acting as Special Master), by the District Court and by the Court of Appeals, it is pertinent to isolate and repeat here the precise statutory provisions formulating the basis for approval of the Plan proposed by the Trustee. These are:

Sec. 216 (11 U.S.C.A. 616) "A plan of reorganization under this chapter —

* * * * * *

"(7) shall provide for any class of creditors affected by and does not accept the plan by the two-thirds majority in amount required under this chapter, *adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims* either as provided in the plan or in the order confirming the plan, (a) by the transfer or sale, or by the retention by the debtor, of such property subject to such claims, or (b) by a sale of such property free of such claims, at no less than a

fair upset price, and the transfer of such claims to the proceeds of such sale, or (c) by appraisal and payment in cash of the value of such claims, or (d) *by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection.*

". . . (9) may include, where any indebtedness is created or extended under the plan for a period of more than five years, provisions for the retirement of such indebtedness by stated or determinable payments out of a sinking fund *or otherwise* (a) if *secured, within the expected useful life of the security therefor,* or (b) if unsecured, or if expected useful life of the security if not ascertainable, then within a specified reasonable time, not to exceed forty years."

STATEMENT OF THE CASE

1. Proceedings Leading to the Petition

Debtor's Petition under Chapter X of the Bankruptcy Act was filed July 27, 1967. Wachovia filed a Motion to Dismiss, raising the issues of whether Debtor's Petition complied with Chapter X and whether it was filed in good faith within the meaning of Sec. 146(3) and (4) of the Act. Following lengthy hearings, the Motion to Dismiss was denied and upon appeal the order of denial affirmed. *Wachovia Bank and Trust Company v. Dameron, Trustee,* (4 Cir. 1969), 406 F. 2d 803. (A-53-58).

Thereafter, the Successor Trustee (R. Kennedy Harris) filed a proposed Plan of Reorganization. Additional hearings were held by the Referee in Bankruptcy, acting as Special Master, on approval of the Plan. The Report of Special Master on Hearing for Approval of Plan of Reorganization (A-13-42), recommended approval of the pro-

posed Plan. The matter then came on for hearing before Honorable Eugene A. Gordon, United States District Judge, who carefully reviewed the proposed Plan and entered an order approving the Plan with a specific modification and additional requirement that Wachovia's secured claim be paid in strict accordance with its terms.

Wachovia's appeal from this order was affirmed by the decision of the United States Court of Appeals for the Fourth Circuit, reported at 455 F. 2d 841, (A-2-11). It is this judgment and opinion which Wachovia now petitions this Court to review by grant of a Writ of Certiorari.

Petitioner contends in its brief that (1) "important and far-reaching questions dealing with the function and application of Chapter X of the Federal Bankruptcy Act are involved"; (2) that "the duty and function of a district judge in considering a plan of reorganization" is involved; and that "the decision of the Fourth Circuit conflicts with applicable decisions of the Supreme Court, as well as other circuits." (Petitioner's Brief, pp 7-8).

A review of the facts and circumstances of this case and the application of the statutory and case law by the Courts below clearly indicate that the foregoing contentions of Petitioner are wtihout merit.

2. **Statement of Facts**

The unique character of the facts of this case, as disclosed by the eighty-seven (87) Findings of Fact appearing on pages 14 through 42 of Petitioner's Appendix, sets it apart from the usual controversy involving Chapter X Plans of Reorganization. The distinctive features of this case were recognized and relied upon by the Referee, acting as Special Master, by the District Judge, and by the Appellate Court in its opinion. Petitioner's recital of facts as set forth in its

brief at pages 8-10 are wholly inadequate to present to this Court a clear and complete picture of this controversy. As stated at the outset of the opinion of the Court of Appeals: "The appeal is largely factual but we will be concise as possible." (A-3).

Petitioner fails to touch upon many factors upon which the Special Master and Court below (including the Appellate Court) considered in approving the proposed Plan of Reorganization. To avoid needless repetition in this brief, Respondent *respectfully urges this Court to examine the Findings of Fact made by the Court* (A 14-42), which set forth in chronological sequence the entire history of this proceeding, including the nature, scope, and extent of the Plan of Reorganization.

The application of the law (particularly Sec. 216 (7) (d)) demonstrates the sound basis for the decision of the Court below.

Special attention is directed to the undisputed fact that Wachovia has always been, and under the approved Plan of Reorganization, will continue to be, the holder of a first lien on Debtor's apartment project. Its loan has been and will continue to be repaid in the manner contracted for repayment. No decrease in interest rate or curtailment payments have been made and none are contemplated.

REASONS FOR DENYING WRIT

The opinion of the Court of Appeals (A 2-11) is not in conflict with any decision of this Court or of any Court of Appeal. It does not deal with any important question of federal law which has "a far-reaching effect" on the use of Chapter X. The opinion simply reflects the application of certain specific statutory provisions to the facts and circumstances of this particular case. As a background for

dealing with the four specific reasons relied upon by Petitioner in its brief, Respondent directs attention to the treatment accorded Section 216 (7)(d) of the Act in Collier on *Bankruptcy,* Vol. 6A, Sec. 16.17, p. 490:

> "Paragraphs (7) and (8), however, contain an omnibus provision which perhaps may be brought into play when other methods fail. Paragraph (7) declares that as to any *non-assenting class of creditors* 'adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims' may be provided '(d) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection.'
>
> "It has been said that these methods, properly speaking, are not 'methods' at all, but merely empower the judge, who must approve and confirm the plan to approve any means of treatment which under the *particular circumstances,* 'equitably and fairly' affords adequate protection to the dissenter.
>
> "Admittedly, the potentialities of paragraphs (7)(d) and 8(c) are difficult to define, but there seems to be little reason why they should not remain effective as possible alternatives *to encompass the largely unforeseen case.*"

Respondent now deals with each of the four reasons assigned by Wachovia in support of its Petition for the Writ.

Petitioner contends:

1. **Decision of the Court of Appeals Approving Plan of Reorganization Violate Chapter X Requirements in**

Impairing Rights of Senior Creditors While Paying Junior Creditors in Full.

This argument presented by Wachovia was duly and carefully considered by the Court below and discussed in detail in the opinion of the Court of Appeals. (A-4, 5). There is no deferred or uncertain aspect in payments to be made to Wachovia. The Court below expressly found there was no 13-month arrearage of unpaid principal. Wachovia's position as holder of the first lien note and deed of trust is not "affected" by the proposed plan. Attention is directed to Finding of Fact No. 13(a) (A-17). See also Findings of Fact Nos. 55 and 56 (A-29, 30) which clearly portray the substantial nature of the collateral security. As stated in the opinion below:

> "We see no merit in Wachovia's contention that its rights are impaired because some junior creditors will be paid in full immediately, or prior to full payment to Wachovia. Wachovia will, under the plan, be paid in full in twenty years. *It has no right to more.*" (A-8).

It is significant to note that the collateral security for Wachovia's note and deed of trust has always been and is now a highly successful operation. (F.F. 55, 56, and 57, A-30).

Wachovia further contends:

2. The Plan Does Not Accomplish a Legitimate Corporate Reorganization Contemplated by Chapter X.

Wachovia raised this question on the first appeal *(Wachovia Bank and Trust Company v. Dameron, Trustee, supra)*, contending that Debtor's petition did not fall within the provisions of Chapter X. The Court rejected Wacho-

via's position at that time, and declined to consider it again on the second appeal (A-8).

S.E.C. v. American Trailer Rentals Co., 379 U.S. 594, 85 S.Ct. 513, 13 L.ed. 2d 510 (1965), cited by Wachovia, expressly holds that Chapter X is permissible in any event if the "financial condition of Debtor requires more than a simple composition of unsecured debts."

The cases cited by Wachovia in support of this contention present factual situations which clearly disclose the obvious impossibility of affecting any plan of reorganization. An example of this is *Arey & Russell Lumber Co. v. American National Bank & Trust Co. of Danville, Virginia,* 4 Cir., 201 F. 2d 508 (1953), relied upon by Petitioner.

Wachovia also contends:

3. The Plan Approved by the Courts Below Adversely Affect the Rights of the Senior Majority Creditor.

Under Point No. 3 in Wachovia's Petition for Writ of Certiorari, there are set forth three separate areas in which it contends its rights are adversely affected. These are:

(a) Wachovia's short-term loan is converted into a different obligation,

(b) Failure to pay Wachovia the principal arrearage, and

(c) It is required to return Debtor's commitment fee.

Each of these contentions was carefully considered and rejected by both the trial court and the appellate court in its opinion (A-4, 5, and 6).

In support of these contentions, Wachovia complains that the proposed plan attempts to rewrite the commitments and agreements between the parties by providing for payment

to Wachovia the full amount of its loan in installment payments rather than payment in full which it anticipated receiving from Aetna upon completion of the 80-unit project. Debtor's obligation is evidenced by a promissory note, *payable by its terms to Wachovia in 240 monthly installments.* This note is secured by an insured first lien deed of trust to Wachovia, with its Vice President, **Archie Walker,** designated as Trustee therein.

Findings of Fact Nos. 74 through 79, inclusive (A-35-36) reflect clearly Wachovia's disregard of the requirement that it tender the loan to Aetna. The contentions of Wachovia must be considered not only in the light of its failure to tender the loan to Aetna, but with attention directed as to the reasons why such tender was not made.

The first opinion of the Court of Appeals affirming the denial of Wachovia's Motion to Dismiss *(Wachovia Bank and Trust Company v. Dameron, Trustee, supra),* succinctly stated the problem as follows:

> "The principal difficulty confronting the debtor is its inability to pay or settle construction claims in the approximate amount of $52,000.00." (Possibly reduced to $28,000/$39,000 as indicated in the footnote), "these claims caused exceptions in the title policy and prevented debtor from giving a first lien on the chattels. While Aetna's commitment was conditioned upon the debtor's payment of all construction costs, Aetna had the option to waive this requirement. The Referee found that Wachovia, however, did not offer the note to Aetna to determine whether it would accept or reject the loan, but instead, without justification, unilaterally called the note and ordered the foreclosure sale."

In its brief, Wachovia attempts to brush aside the estab-

lished fact that *after* the apartment project was completed in accordance with the plans and specifications and substantially 100% occupied (F.F. 54, A-29), and prior to Wachovia's unilateral declaration of alleged default and attempted foreclosure that it made no effort to tender the loan to its correspondent Aetna for purchase. Aetna's obligation to purchase was contingent upon certain enumerated provisions set forth in the "Buy and Sell Agreement," with a proviso that: *"Aetna shall have the option to make said purchase even though less than all of the conditions hereinafter provided shall have been met."* (F.F. Nos. 65, 76, 77, and 78, A-32, and 35, 36).

The very nature of Wachovia's loan commitment to Debtor plays an important part in weighing the equities of the proposed plan and in part answers the argument presented by Wachovia. Debtor corporation was capitalized with $400.00 of issued stock and this fact was known to Wachovia at the time its commitment was made. The sole financial requirement imposed by Wachovia was that the borrower provide $21,000.00 to cover (1) a down payment of $12,000.00 to be made to Kavanagh-Smith & Company as part of the $45,000.00 purchase price for the land upon which the project was to be constructed (the balance of $33,000.00 to be evidenced by Debtor's promissory note, payable in monthly installments of $482.10 for a period of seven years), (2) payment of a commitment fee of $6,400.00, and (3) payment of title insurance premium of approximately $1,800.00. The $21,000.00 was provided by Debtor's stockholder as a loan to the corporation. Under the proposed Plan, this loan is extinguished and treated as a capital contribution to Debtor corporation.

All parties were fully aware that the estimated cost of Debtor's project would consume virtually the full amount of the loan, and it is reasonable to assume that except for

delays incurred when the major supplier of Debtor went bankrupt, the project would have been completed with the loan funds. It was evident from the beginning that the commitment of Wachovia and Aetna was for all practical purposes a 100% loan.

By reason of the substantial amount of its loan, coupled with the increase in interest rates occurring during the period of construction (May 1966-May 1967) (F.F. No. 64, A-32), Wachovia virtually precluded any refinancing of its loan.

The thrust of Wachovia's contentions relate to the unpaid claims for material and labor remaining after completion of the project. The existence of these claims (at the time amounting to less than $50,000.00) was assigned as Wachovia's reason for declaring the loan in default and as the principal basis of its decision not to tender the loan to Aetna.

Yet, notwithstanding the marginal nature of Wachovia's loan, Debtor corporation completed its project and subsequent events have proven its ability to amortize all secured creditors without difficulty. Every monthly payment due the second lien secured creditor, Kavanagh-Smith & Company, has been made in accordance with its note. The proposed plan provides for a continuation of these payments in exact accordance with the terms of the note. Strangely, Kavanagh-Smith & Company has filed its objection to the plan. Perhaps, this is to some extent explained by the fact that in July 1967, Debtor obtained an additional $50,000.00 loan to be secured by a second lien deed of trust (F.F. No. 52, A-28). These funds were available to pay off in full all unsecured creditors. At the eleventh hour, Kavanagh-Smith & Company, holders of a second lien purchase money deed of trust, declined to agree to subordinate its relatively small

lien to the new loan. As a result, the $50,000.00 loan was not closed. Shortly thereafter, Wachovia undertook to foreclose its deed of trust. Finding of Fact No. 70 (A-34) now again becomes significant. Debtor was precluded from paying off its unsecured creditors and avoiding the attempted foreclosure by the very Company which had been holding discussions with Wachovia relating to a proposal to purchase Debtor's property from Wachovia upon the foreclosure!

During the course of construction (which commenced in May, 1966), at monthly intervals, disbursements were made by Wachovia based on a schedule of work completed and unpaid obligations arising therefrom, each schedule approved by the architect. At the time of each such disbursement, an inspection was made of the job site and the progress of construction by an official of Wachovia. (F.F. No. 38, A-24). After completion of four of the five 16-unit buildings, in April, 1967, and *before Wachovia or Aetna were aware that the balance of undisbursed funds would not* be sufficient to pay all costs of construction, Debtor was advised Wachovia did not intend to "close" the loan by assigning it to Aetna (F.F. No. 41, A-25), and that it should seek a new loan from an independent source. As stated above, the amount of Wachovia's loan, together with the substantial increase in interest rates, prohibited Debtor from pursuing this course of action, particularly with the further increase in interest rates thereafter to 9½%-10% in December, 1969 (F.F. No. 64, A-32).

Both the Special Master and District Judge considered Wachovia's numerous contentions that its loan was in default when it refused to accept the installment payment tendered by Debtor on July 1, 1967. Both determined that no default existed which justified the attempt by Wachovia to demand payment in full of Debtor's obligation (F.F. Nos. 46, 47, 48, 49, 51, and 53, A-27-28).

The title insurance policy insured Wachovia's deed of trust as a first lien on Debtor's apartment project (F.F. No. 53, A-28-29). No condition has ever existed which has impaired the effect of this policy, since the deed of trust has been, since its recordation, and still is, a first lien deed of trust. Wachovia's officer, Archie Walker, (and also trustee in its deed of trust) was president of the company acting as broker for the company issuing the title policy and as such made his own determination as to requirements and conditions in respect to said policy (F.F. No. 68, A-33). This created an obvious conflict of interest.

Lastly, when foreclosure was undertaken by Wachovia, it was precipitated by this same officer (Walker) who was the Trustee in its deed of trust and a vice president of Wachovia as well. Since the decision of the North Carolina Supreme Court in *Mills v. Building and Loan Association*, 216 N.C. 664, 6 S.E. 2d 549, lending institutions have designated substitute trustees for their own officers to insure impartiality in the performance of the duties imposed upon the trustee. Under the circumstances of this case (with Kavanagh-Smith & Company's interest in purchasing Debtor's property), Wachovia's undertaking to foreclosure, with its Vice President acting as Trustee, is subject to careful judicial scrutiny.

Wachovia's contentions under POINT 3 of its argument, in view of the facts disclosed by the record before this Court, are without substance.

Wachovia finally contends:

4. **District Court and Circuit Court Misconstrued the Role of the District Judge in Passing Upon Plan of Reorganization Under Chapter X.**

United States District Judge Eugene A. Gordon was thoroughly familiar with the facts of this case by reason of

his prior ruling on Wachovia's Motion to Dismiss. In that instance he specifically held that certain Findings of Fact were not supported by the record and not adopted by the Court. Subsequently, careful and detailed attention to this matter was made by Judge Gordon in respect to the hearing held to determine whether the proposed Plan of the Successor Trustee should be approved.

On November 9, 1970, the parties were afforded opportunity to and did present oral argument to the Court. Wachovia and Respondent were each directed to present to the Court proposed Findings of Fact and Conclusions of Law. This was done.

In preparing his order approving the proposed Plan, Judge Gordon again demonstrated the detailed attention given to his consideration of the proposed Plan. His order recites, in part:

> "After hearing oral arguments and considering the official file, including *transcripts, exhibits,* and briefs, it is determined that the *findings of fact* and *conclusions of law* of the Referee are neither arbitrary nor clearly erroneous, and the Court adopts the same for the purpose of approving the Plan of Reorganization submitted by the Trustee."

There was nothing "perfunctory" or "offhand" in the Court's approval of the Plan. Counsel for Wachovia had ample opportunity to (and did) augment its written objections by oral argument. The hearing was held on November 9, 1970. All proposed findings and briefs were filed by December 21, 1971. More than two months later, Judge Gordon rendered his decision. There is no doubt that the entire matter received the "informed, independent judgment" of the Court. To infer otherwise is a reflection on the

conscientious Judge who obviously gave this matter careful attention before arriving at his decision.

Respondent contends:

The Decision of the Court of Appeals is Correct.

Petitioner attacks the decision of the Court of Appeals as being predicated upon an erroneous application of the law to the facts as found by the trial court. The decision below demonstrates a careful, in depth, analysis of unique facts of this case and the application of the pertinent provisions of Chapter X to these facts. In the last analysis, the bankruptcy court is vested with broad equitable powers. While the Act does impose certain limitations upon the exercise of these equitable powers, the flexibility granted to the Court in approving a plan is clearly evidenced by the language of Section 216(7)(d) set forth above. There is nothing in the decision of the Court of Appeals to indicate that the approval of the plan submitted by the Trustee in this case transcends the proper exercise of proper judicial authority.

As stated in Collier on Bankruptcy, Vol. 6A, Sec. 10.02, pp. 416-418:

> "A plan of reorganization, and indeed the whole reorganization process envisions the maintenance of the going-concern values of the debtor . . . . It does mean that the business enterprise involved will, if possible, be refurbished in some fashion so that it may continue to operate as a sound commercial and economic unit. The devastating and final effect of foreclosure or ordinary bankruptcy, with the attendant loss of values through forced sales and the rigid and inflexible procedure afforded, is thereby avoided."

The action of both the Special Master, the District Court, and the Court of Appeals in approving the Plan of Reorganization finds ample support when attention is directed

to how the Plan affects Wachovia. A firm commitment was made by Wachovia in 1966 to lend Debtor $640,000.00, with interest at the rate of six per cent (6%) repayable in twenty (20) years, in monthly installments of $4,586.67, commencing April 1, 1967 (extended by agreement to July 1, 1967). As security for repayment of the loan, Wachovia obtained from Debtor a first lien deed of trust on Debtor's 80-unit apartment project. Thereafter, the apartment project was completed in accordance with the plans and specifications therefor and within the period specified by Wachovia. Under the proposed plan, Wachovia remains the holder of the first lien deed of trust (recorded May 13, 1966) which it has always possessed, with no impairment of its position as a first lien creditor. Notwithstanding its operation under a trusteeship, the apartment complex has been successful with a high percentage of occupancy over the past four years. Without difficulty, the Trustee has made continuous successive monthly payments of $4,586.67 to Wachovia since October 1, 1967. A continuation of these payments as provided by the plan will pay back to Wachovia with all interest, within the twenty-year period commencing on July 1, 1967, all but $891.21 of the funds loaned to Debtor (a total of $632,726.45 having been loaned). Provision for payment of this sum within the twenty-year period is required by the Plan. Simply, and in its essence, the Plan provides for the same security and repayment as initially contemplated.

CONCLUSION

For the reasons above set forth, Respondent respectfully requests this Court for the entry of an order denying the Petition for a Writ of Certiorari.

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